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How Can They Charge That? (And Other Questions)

By ROBERT H. FRANK

WHY do tickets to popular Broadway shows command premium prices, while movie theaters charge the same price for popular films as for clunkers? Things in high demand generally command higher prices, so why not blockbuster films?



Danny Schwartz

This question came from Peter Hlawitschka in an “Economic Naturalist” writing assignment for my economics course at Cornell’s Johnson Graduate School of Management. For years now, I’ve asked students like Mr. Hlawitschka to pose an interesting question based on something they have observed or experienced, and then employ basic economic principles in an attempt to answer it. Don’t try to

submit a finished research study, I tell them. Just look around for something that seems puzzling and try to construct a plausible explanation suitable for future testing.

Mr. Hlawitschka began by noting an important difference in the cost of delivering movies and plays. Once a film has been produced, the cost of each additional showing is relatively low — basically, just the theater rental and wages for the box office clerk, projectionist and ushers. For a play, there are not only those costs, but also the entire cost of staging the production — cast, crew and others — for each performance.

Charging the same price as for less popular plays would make it impossible to accommodate everyone who wants to see a big hit. Far better would be to ration scarce seating by charging a premium price. With a popular movie, by contrast, additional copies can be made at minimal cost, and large audiences can be accommodated by showing it many times a day on multiple screens. By keeping prices low, theater owners can fill many more seats and generate far more revenue than they could by charging premium prices at a more limited number of screenings.

Mr. Hlawitschka's surmises would need to be empirically proved. But the thought behind them is just what this writing assignment was intended to elicit.

The assignment is my response to the distressing finding that six

months after having completed a standard introductory economics course, students are no better able to answer questions about basic economic principles than others who have never even taken economics. In standard courses, hundreds of concepts — many of them embedded in complex equations and graphs — often seem to go by in a blur. In contrast, grappling with questions that students care about appears to be a far more effective learning strategy. And that's in no small part because the problems they pinpoint are so intriguing.

For example, another student, Chris Kissane, observed that motorists who receive costly speeding tickets are typically granted large fine reductions just for appearing in court, even when they offer no evidence of mitigating circumstances. Why, he wondered, should a brief court appearance cut a speeding fine by two-thirds or more?

He began by suggesting that the challenge of local governments is to devise an incentive system that deters high-income motorists from speeding without imposing crushing economic burdens on drivers with lower incomes. Noting that means-tested fines would probably be unlawful, he proposed that governments may simply be employing the familiar retailer's strategy of making price discounts available to potential customers who wouldn't buy without them.

Many sellers, for example, offer substantial price breaks to buyers who mail in a rebate coupon. That strategy works because most buyers who are willing and able to pay high prices won't bother to jump that hurdle. Having to appear in court, Mr. Kissane argued, is a

similarly effective hurdle because the high value of a wealthy motorist's time would make it irrational to lose several hours in court just to save a few hundred dollars. But those who work for low wages or are retired, unemployed or still in school would regard that same savings as ample compensation for a brief court appearance.

It's fun to watch the learning process unfold during the semester. The week before their first paper is due at midterm, students often ask whether the questions they have in mind are sufficiently interesting. Frequently, I tell them they've still got several more days and might want to think a little longer. But when students come by late in the term, before the second paper is due, they're more likely to be having trouble choosing among several interesting options. A common query is: "Professor Frank, can I do a medley?" Between midterm and term's end, their brains have somehow become rewired to see the world differently.

HERE'S a final example, this one by Justin Barclay: "Why do airlines now offer deep discounts to travelers who are willing to let someone else choose their destination?" Travelers who visit GetGoing.com and choose the dates they want to travel to either of two cities are offered discounts of up to 40 percent off published fares. Once they've paid, GetGoing chooses one of the cities at random, and the deal is done.

This practice, Mr. Barclay argued, is an effective way of targeting discounts to leisure travelers, who are more price-sensitive than business travelers. If you're traveling on business, you can hardly

allow your destination to be **determined by a coin flip**.

Studying biology enables people to observe and marvel at many details of natural environments that otherwise would have escaped notice. In much the same way, mastering a few basic economic principles can cast the mundane details of ordinary existence in a sharp new light.

On the basis of e-mails from former students over the years, I've concluded that the Economic Naturalist assignment was an effective response to my concern about the ineffectiveness of traditional introductory courses. Once students discover how costs and benefits shape everyday experience, their mastery of economic principles doesn't decay over time; it grows stronger.

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